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COMPENSATION FOR SECURITY INTERESTS IN EXPROPRIATED LAND

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INSTITUTE OF LAW RESEARCH AND REFORM

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REPORT ON COMPENSATION FOR SECURITY INTERESTS IN EXPROPRIATED LAND

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Table of Abbreviated References

	Enactment	Abbreviation
Alberta	Expropriation Act, Statutes of Alberta, 1974, c.27.	1974 Expropriation Act
	Expropriation Act, R.S.A. 1980, c. E-16.	Expropriation Act
Ontario	Expropriation Act, R.S.O. 1970, c.54	Ontario Expropriation Act
	Report	
Alberta	Institute of Law Research and Reform, Report No. 12 1973, Expropriation.	Report No. 12
Ontario	Ontario Law Reform Commission, Report on the Basis for Compensation on Expropriation 1967.	The Ontario Law Reform Commission's Report

REPORT ON COMPENSATION FOR SECURITY INTERESTS IN EXPROPRIATED LAND

I. Summary of Report

This report deals with the compensation payable when land which is subject to a mortgage or other security interest is expropriated.

The present law on the subject is unique to Alberta. It is contained in s.49 of the Expropriation Act, which is based upon the "market value" theory. Under that theory, the security holder is entitled to be paid the market value of the security interest, which may be greater or less than the outstanding amount secured by the security interest (the outstanding balance), and the landowner is entitled to be paid the market value of the ownership interest, valued separately from the interest of the security holder. The total of the compensation paid to the security holder and the landowner may be greater or less than the market value of the land valued as if unencumbered.

Under the "market value" theory, the compensation for the security holder is likely to be less than the outstanding balance if the interest rates which prevail at the time of expropriation are higher than the mortgage interest rate or if the security is shaky. It is likely to be more than the outstanding balance if prevailing interest rates are lower than the mortgage interest rate.

We have concluded that with respect to the valuation of security interest in land,

(1) the "market value" theory is fatally defective, can cause serious injustice, and cannot be cured by judicial interpretation,

(2) the "market value" theory, because of its theoretical complexities and because it requires expert investigations and litigation which would otherwise be unnecesary, imposes unacceptable costs on the parties to the expropriation.

The "market value" theory works if an expropriated interest in land has a separate value and can be bought and sold. The security interest is unique among interests in land in that it has no existence or value except in association with the obligation which it secures. The obligation, however, is not land and is not expropriated, so that it is improper to include it in the valuation.

If the expropriation takes all of the land affected by the security interest, and if there is no other security for the obligation, and if there is no person against whom the obligation can be enforced, the objections outlined above do not give rise to practical problems. However, legislation is not suitable for Alberta if it is unworkable with respect to mortgages under The National Housing Act, mortgages and agreements for sale entered into by corporations, and security interests for which there is other security or a guarantee.

The report therefore recommends that Alberta revert to the "outstanding balance" theory which is in force in every other common law jurisdiction in Canada. Under that theory, the security holder is first paid the outstanding amount secured by the security interest, up to the market value of the expropriated land, and the landowner is paid the balance, if any. The amount paid to the security holder is applied to the amount outstanding against the security interest.

The report goes on to deal with the uncommon case in which the amount secured by a security interest is not ascertainable.

In such a case, the security holder would be paid the "fair value" of his interest as determined by the Land Compensation Board and the landowner would be paid the market value of his interest valued subject to the security interest.

Attached to the report are draft amendments to the Expropriation Act which would give effect to our proposals.

II. Report

1. Introduction

A. Reasons for Report.

1.1 This report addresses two questions about the amount of compensation payable for the expropriation of land which is subject to a security interest. The first question is: how should the compensation for the security interest be determined? The second is: what effect, if any, should the amount of compensation paid for the security interest have upon the amount of compensation to be paid for the landowner's interest?

1.2 By "security interest" we mean any interest which is held as security for the performance of an obligation. The mortgage is the most common security interest. An agreement for sale under which the seller retains title as security for the payment of the purchase price is a security interest. A charge upon land to secure the payment of an annuity is a rarer one. Ingenuity may devise others. In earlier times in this province, for example, it was not uncommon for an older couple to transfer the family farm to a son subject to the older couple's right to live in a house on the land and subject also to the older couple's right, which was usually secured on the land, to receive food and fuel. The great bulk of security interests secure payment of ascertainable sums of money, but expropriation law must recognize the possible existence of some which do not.

1.3 Under the Expropriation Act the principal element in the compensation for expropriated land is the market value of the land. Under s.41, "market value" "is the amount which the land might be expected to realize if sold in the open market by a willing seller to a willing buyer. Under s.49(1), if the land is subject to a security interest, the market value of each

interest is to be established separately. We will refer to the theory behind this measure of compensation as the "market value" theory. We reproduce as Appendix A the provisions of the Expropriation Act which are relevant to the theory.

1.4 Alberta is the only Canadian jurisdiction which uses the "market value" theory to compensate the owner of a security interest, although both the British Columbia Law Reform Commission and the Law Reform Commission of Canada have recommended that their respective jurisdictions adopt it. The "market value" theory was first embodied in the 1974 Expropriation Act which effected a thorough overhaul of expropriation law and practice in Alberta and which was based upon our Report No. 12, Expropriation.

1.5 Under the law of Canadian jurisdictions other than Alberta, and indeed of most if not all other common law jurisdictions, the holder of a security interest in expropriated land is paid the outstanding amount of money which is secured by the security interest. That amount cannot exceed the compensation which would otherwise be paid to the owner of the land and is deducted from it. We will refer to the theory behind this measure of compensation as the "outstanding balance" theory.

1.6 We decided to review the principles of compensation for security interests for three reasons. First, the Mortgage Loans Association, which is composed of major mortgage lenders, has from the first objected strongly to the "market value" theory, and has continued to urge a reasoned case against it which requires either rebuttal or recognition. Second, the decision of the Land Compensation Board in Forster Mah Enterprises Ltd. v. The City of Calgary ((1981) 20 Land Compensation Reports 262) showed that the application of the "market value" theory could lead to undesirable results. Third, our own continuing analysis has suggested that the application

of the theory presents insurmountable difficulties.

B. Consultation.

1.7 In March, 1982, we issued a Memorandum for Discussion on the subject. In response to it we received comments from a number of individuals and groups who are listed in Appendix B. The comments have given us much food for thought, and we will make specific reference to some of them.

2. Problems in the Existing Law

A. Cases in which the outstanding amount can be determined.

(1) Problems.

(a) Unworkability of the "market value" theory.

2.1 We have reluctantly concluded that the "market value" theory is fatally defective and cannot be repaired by judicial interpretation. We will now set out our reasons for that conclusion with respect to cases in which the outstanding amount secured by the expropriated security interest can be determined. That conclusion is the principal reason for this report.

2.2 It is not uncommon for the holder of an expropriated security interest to have other securities for the payment of the money secured by the security interest. It is also not uncommon for him to have a personal claim for the money against the landowner under a covenant to pay. We do not think that there is a rational way in which legislation based upon the "market value" theory can cope with either situation. The only possible courses of action are as follows:

(1) To include the value of the covenant and other

securities in the market value of the expropriated security interest and require the expropriator to pay the security holder for them. This procedure would be unfair to the expropriator, which would have to pay for something which it did not take and from which it could not benefit.

(2) To exclude the value of the covenant and other securities from the market value of the expropriated security interest, and to discharge them. This procedure would deprive the holder of the security interest, without compensation, of the value of the covenant and other securities.

(3) To exclude the value of the covenant and other securities from the market value of the expropriated interest, and to leave them in force. Under this procedure, after the compensation is paid to the security holder there would be no rational way to determine what balance, if any, remains owing, upon the obligation. The only procedure that would not be entirely arbitrary would be to apply the compensation against the mortgage account (to use a mortgage as the example). However, if that were done the mortgage lender would ultimately be paid his principal together with interest at the contract rate, and no more, so the whole valuation process would be pointless.

2.3 The problems created by any of the procedures mentioned in paragraph 2.2 would be much worse in more complex cases. First, a loan may be made to a corporation largely upon its general credit but with a piece of land as a minor security; it would be unfair, merely because the land has been expropriated, to wipe out the obligation upon payment of compensation for a security of comparatively small value. Second, there may be joint borrowers or guarantors affected, and there is no reason why their relationship to the lender should be affected by the market value of one security for the obligation.

2.4 The Expropriation Act deals in three different ways with the problem of the balance owing after compensation is paid to the security holder. First, s.49(2) provides that if there is a covenant but no collateral security, the "security interest shall be deemed to be fully paid, discharged and satisfied." We think that this is not satisfactory, for the reasons which we have given. Second, s.49(3) provides that if there is collateral security, the debt is not fully discharged and the Land Compensation Board is to determine the balance owing and the manner in which it is to be repaid. This seemed fair to us at the time of Report 12, but it does not provide the Board with a legal principle upon which to make its determination of the balance owing, and, in the light of what we have said above, we do not see what legal principle the Board could develop for itself. Third, s.49(4) provides that in the case of a partial taking, which is really a special case of the existence of other security than the expropriated land, the Board is to determine the market value of the expropriated part of the land and distribute the compensation.

2.5 The "market value" theory was applied in the case of Forster Mah Enterprises Ltd. v. City of Calgary ((1980) 20 Land Compensation Reports 262). There the expert evidence was that the value of a mortgage securing $110,000 had to be discounted to $102,000 because of differences in interest rates and other factors, including weakness of the security. The Board then found that the market value of the land was $100,000 and that a prudent lender would lend only 75% of the value of the land, so that the market value of the mortgage was $75,000. The Board then deducted the $75,000 from the market value of the land and awarded the owners $25,000; the "prudent lending ratio" was thus the decisive factor in both awards. The result was that an amount was deducted from the mortgagee's compensation and paid to the owners of property which was more than fully mortgaged. The weakness of the security brought about the result, though weakness of security does not appear to us to be a reason for

giving a landowner a benefit at the expense of the mortgagee.

2.6 In the Forster Mah case the Land Compensation Board was very careful to restrict its remarks to the evidence and arguments before it. The case is therefore not likely to be a precedent. Further, the Expropriation Act could, without rejecting the "market value" theory, be amended so as to avoid the application of a prudent lending ratio in valuing a security interest or so as to make it clear that the owner is not to receive a benefit because of the application of a prudent lending ratio. The case however, is worrying because it demonstrates that the application of the "market value" theory may lead to unforeseen difficulties and because of the additional complications which would have to be introduced into the legislation to avoid the specific difficulties which the application of the theory caused in the case.

2.7 The difficulties with the "market value" theory, as it is embodied in s.49 of the Expropriation Act, will not give rise to practical problems in a case in which there is no person liable on a covenant or obligation to pay, and in which there is no other security, and in which all the land subject to the security interest is expropriated. In such a case everything of value would be taken under the expropriation and would be paid for. Under s.41 to 43 of the Law of Property Act, R.S.A. 1980 c.L-8, these conditions are substantially met by an ordinary mortgage or agreement for sale executed by an individual as mortgagor or purchaser, but only if there is no other security and the whole of the land subject to the security is taken. However, we do not think legislation is suitable for Alberta if it is unworkable with respect to mortgages under The National Housing Act, mortgages and agreements for sale entered into by corporations, and security interests for which there are other securities or guarantees.

(b) Existence of a market.

2.8 The application of the "market value" theory depends upon the existence of something which can be characterized as a "market" in which a willing seller might find a willing buyer. There is a market for many secured obligations, particularly for specific mortgages of individual properties. However, if the security holder holds a right to receive money, and if that right is secured not only by the expropriated interest but also by a personal covenant or obligation or other security, no one would buy the expropriated interest without the obligation; there is no way to separate the security from the obligation for investment purposes. If no one would buy the security interest without something else there is no willing purchaser and no "market" for the security interest unaccompanied by the other thing, and the "market value" theory of compensation for the expropriated interest breaks down.

(c) Cost and delay.

2.9 The application of the "market value" theory involves much more trouble, expense, litigation and delay than the application of the "outstanding balance" theory which is the alternative which we will propose. The outstanding amount under a secured loan is in most cases quite easy to compute from records which are in the possession of the lender or the borrower or both, and the parties can usually agree upon it. Ascertaining the market value of a security interest, on the other hand, usually requires expert investigations of circumstances relating to the market for security interests, the prevailing interest rates, and the strength of the security and of any covenants or collateral securities. There is much room for differences of opinion which can be settled only by extensive negotiation or by protracted litigation. This consideration will not be decisive if there are strong considerations to the contrary, but it is important.

(d) Avoidance of the "market value" legislation.

2.10 The application of s.49 of the Expropriation Act can be, and often is, avoided by inserting in a mortgage a clause making the whole amount secured due and payable upon expropriation. If the balance is or becomes due on expropriation, then the market value of the security interest, if it can be ascertained, is likely to be the same as the outstanding amount which it secures. We understand that most large-scale mortgage lenders insert such clauses in the mortgages which they take. A provision for optional acceleration, if effective, would give the mortgagee a choice between market value and payment of the outstanding balance which would not be understood by the borrower when he signed the documents. No doubt the Act could outlaw provisions for acceleration upon expropriation. That would, however, overrule the parties' freedom of contract, and we do not think that there is a social interest in the "market value" theory which is strong enough to justify such a provision. The fact that the Act can be avoided does not necessarily mean that the Act should be changed, but it is a consideration to be borne in mind when assessing the present Act.

(e) Difficulties for large scale lenders.

2.11 Compensation according to the "market value" theory causes substantial problems for large scale mortgage lenders. Payment to such a lender of either more or less than the outstanding balance causes complex accounting problems as to the treatment of the loss or the gain. The receipt of less than the outstanding balance raises a question whether or not the difference is recoverable from the insurer of the mortgage and whether or not such a recovery will affect the premium. In its comments to us the Mortgage Loans Association said that its members would be content to receive payment of the outstanding

balance on an 18% mortgage in a time of 15% rates so long as they could be paid the outstanding balance on a 15% mortgage in a time of 18% rates. The Association's views are a factor to be considered, particularly since there seems to be no reason to think that as a class mortgage lenders will in the long run be more favoured by the application of one theory than by the application of the other. Finding a solution to mortgage lenders' problems would not of itself justify changing an otherwise beneficial law but the existence of the problem should be noted.

(2) Possible solutions.

(a) A "discounted cash flow" theory.

2.12 We have had urged upon us a middle course which has been thoughtfully developed and which is intended to preserve the essential fairness of the "market value" theory but to avoid the difficulties which we have enumerated. The argument starts with the proposition that the security interest and its incidents embody the result of the assessment by security holder and landowner of their respective interests and expectations, and that the expropriation procedure should so far as possible take into account those assessments and the interests and expectations assessed. Payment of the outstanding balance, on the contrary, is the immediate payment of a future sum and is inconsistent with any such balancing process. The suggested procedure would be as follows:

(1) to determine the amount and time of the payments which the security holder would have received but for the expropriation.

(2) to determine and apply a discount factor to arrive at the present worth of the payments.

(3) to pay the security holder the discounted amount, and, if that amount is less than the market value of the expropriated land, to pay the balance to the landowner.

(4) to discharge the security interest and the loan obligation.

In the result, the expropriating authority would pay the higher of (a) the discounted value of the payments secured by the security interest and (b) the market value of the expropriated land.

2.13 This proposal would make two substantial changes in the present law. The first is that it would not use the "market value" test. Instead, the test would be the discounted value of the expected cash payments. Thus, the proposal would not take into account the "prudent lending ratio", though the discount factor would probably reflect any weakness in the security. The second substantial change is that the proposal would in the usual case require the compensation paid to the security holder to be deducted from the compensation payable to the landowner.

2.14 The proposal is attractive. The principal arguments in its favour are that the determination of the discount factor would involve the balancing of the risks and expectations which the parties had in mind, and that the proposal would provide an objective standard for valuation which would avoid some of the problems of the "market value" theory.

2.15 We think, however, that the proposal does not resolve the problems which we have outlined in paragraphs 2.1 to 2.11 above. The discharge of the whole obligation would, we think, work unfairly in the case of a loan the amount of which is based primarily upon the strength of the borrower's credit, the covenants of joint borrowers or guarantors, or other securities, or some combination of these, and which therefore is not

entirely based upon the value of the expropriated land. Unless the weakness of the security is specifically excluded as a factor in determining the discount rate, it would paradoxically go to reduce the security holder's compensation and increase the landowner's compensation as happened in the Forster Mah case; and if it is not excluded the proposal would require the expropriator to pay the security holder an amount in excess of the market value of the land, something which the security holder could never obtain in any other way. For these reasons we do not feel able to recommend the adoption of the proposal.

(b) The "outstanding balance" theory.

(i) General.

2.16 The only practicable alternative which we see to the "market value" theory is the "outstanding balance theory" under which the security holder would be paid the outstanding amount secured by the security interest so long as that amount does not exceed the amount of compensation payable to the landowner for the market value of the land, and under which the landowner's compensation would be the balance remaining after the security holder is paid. The amount paid to the security holder would apply against the amount secured. The security holder would retain all of his other remedies for collection of any balance owing after the compensation is applied to the secured account.

2.17 The great objection to the "outstanding balance" theory is that the compensation which it gives the security holder will usually be different from the value of the security interest. If a mortgage loan secured by expropriated land was advantageous to the mortgage lender, payment of the amount outstanding will not enable him to find as good an investment as that which the expropriation has effectively taken from him, and if the loan was disadvantageous to him payment of the face value will allow him to find a better investment. The effect on the

landowner will be the reverse of that on the mortgage lender. In those rare cases in which the terms of the mortgage loan are roughly the same as those which the lender could get under the conditions prevailing at the time of the expropriation, the compensation will be fair to both sides, but not otherwise. Nevertheless, as we have said, we think that the practical considerations which we have outlined militate against the "market value" theory. Although justice dispensed by legislation based upon the "outstanding balance theory" is rough and ready it conforms to the contractual obligations of the parties and it seems to us to be the closest approximation to justice which is available under the circumstances of an expropriation.

(ii) Application of payment made to security holder.

2.18 If the "outstanding balance" theory is adopted, there is one consequential question which should be addressed. It is this: should the compensation paid to the security holder merely reduce the outstanding balance, leaving payments to fall due as the contract or other document provides? Or should the compensation be applied on payments as they fall due? It may be awkward for the landowner to continue payments immediately if he was relying on income from the expropriated land to do so. However, we think that the compensation should merely go to reduce the principal unless the parties otherwise agree. First, an interruption of payments may be as unfair to the security holder as continuing them is to the landowner. Second, the apparently common provision for acceleration of payments on expropriation would defeat a provision applying the compensation on payments as they fall due unless the provision is made to override the agreement of the parties, something which we do not think would be acceptable.

(iii) Partial taking.

2.19 If only part of the land which is subject to the security interest is expropriated, to whom shall the compensation be paid? The choices are: to the security holder; to the landowner; or to both, according to a formula. At p.34 of its Report the Ontario Law Reform Commission chose the latter, and s.17(b) of the Ontario Expropriation Act accepted the choice. The Commission thought that it would be both simple and fair that the mortgagee should receive a payment which would preserve the pre-existing ratio between the amount secured and the value of the security. The payment should come from the market value portion of the landowner's compensation, and also from the damages for injurious affection, as both are reflected in the diminished value of the remaining land. We have some doubts about the simplicity of the proposal as it could theoretically result in otherwise unnecessary valuations of other securities. We think a good case could be made in logic for paying the whole compensation to the security holder, as the payment would enure to the landowner's benefit by reducing the amount outstanding. We have, however, concluded that the Ontario proposal should be adopted. There should be something tangible for the landowner from the expropriation, and providing something tangible is likely to promote settlements.

(iv) Priority of security interests.

2.20 If there are more security interests than one, the total amount payable to the security holders should still be not more than the compensation payable to the landowner for the land. The order of priority which the general law gives to the security holders should be observed.

(c) Recommendations.

Recommendation No. 1

We recommend that where expropriated land is subject to a security interest and the outstanding amount secured by the security interest can be ascertained, the compensation payable to the security holder:

(a) shall be the outstanding amount secured by the security interest at the effective date of the expropriation,

(b) shall not exceed the market value portion of the compensation payable to the owner of the land,

(c) shall be deducted from the market value portion of the compensation payable to the owner of the land, and

(d) shall be applied against the amount secured by the security interest.

See proposed legislation, s.49(2)

Recommendation No. 2

We recommend that where the expropriated land is subject to more than one security interest:

(a) the aggregate compensation payable to all the security holders shall not exceed the market value of the land, and

(b) compensation shall be paid to the security holders in the order of the priority of their respective security interests.

See proposed legislation, s.49(3)

Recommendation No. 3

We recommend that where the expropriated land is not all the land subject to the security interest the security holder shall be entitled to be paid out of the compensation for the land expropriated and the damages for injurious affection to the land which is not expropriated the amount that will preserve the pre-existing ratio between the amount secured and the value of the security.

See proposed legislation, s.49(5)

B. Cases in which the amount of money secured by a security interest cannot be determined.

2.21 We have so far been discussing cases in which a security interest secures the payment of an ascertainable amount of money. We now turn to cases in which it does not. These would include, for example, a lifetime annuity charged on land, or a charge securing goods or services of an indeterminate amount (such as a charge securing the provision of food and fuel which we have mentioned in paragraph 1.2). They are comparatively rare, but we think that expropriation law should provide for them.

2.22 A provision that a security holder is to be paid the amount secured by the security interest is not capable of intelligent application to a case in which the amount secured cannot be ascertained. We think that some other theory of compensation must be adopted for such cases. The "market value" theory will not be appropriate. There is almost certain to be no true "market". While the courts have sometimes been able to find a "market value" in the absence of a true market, we do not think that legislation should compel an adjudicator to do so. What a willing purchaser would pay for a security interest of such a strange kind may not be a fair test of the value of the interest.

2.23 We think that the only thing to do is to provide that the security holder will receive the "fair value" of his interest, and to leave it to the adjudicator to decide how to arrive at that fair value. The term "fair value" is not unknown to our law; under s.184(3) of the Business Corporations Act, S.A. 1981, c.B-15, for example, a dissenting shareholder is under certain circumstances entitled to be paid for his shares their "fair value" as determined by the Court. It is a term which obviously leaves much discretion to the adjudicator. We think that it is highly likely that, in the absence of

overriding circumstances, a lifetime annuity charged on land would be valued at the discounted value of the annuity payments, during the annuitant's life expectancy, or in an amount equal to the cost of a similar annuity, but we think that to legislate such a result would introduce undesirable complexity and inflexibility into the law. The class of security interests which do not secure ascertainable amounts of money, while probably quite limited in number, is limited in kind only by human ingenuity, and we do not think that it would be helpful or useful to try to enact detailed rules to govern such a disparate class.

2.24 The next question is whether or not the amount payable to the security holder, being the "fair value" of the security interest, should be deducted from the compensation payable to the landowner. We have given an affirmative answer to a similar question where the outstanding amount secured by the security interest can be ascertained. It is arguable that an affirmative answer should be given here as well: the landowner's interest is subject to the security interest and is obviously less valuable because the security interest exists, so that fair compensation to the landowner should reflect a deduction for the fair value of the security interest.

2.25 We think however that the landowner's interest should be valued separately, though of course, subject to the burden imposed by the security interest. Our reason is that we are dealing with an unforeseeable class of security interests. In an unforeseeable class there may well be some security interests the money value of which to the security holder is different from the money value of the detriment which they impose upon the landowner. An example might well be the charge for food and fuel which we have mentioned in paragraph 1.2. The value of the food and fuel to the senior couple might well be much more substantial than would the burden on the younger couple of providing it. We recognize that there could well be great

difficulties in the valuation of the interests of both the security holder and the landowner under our proposal, but we do think that they can be valued and that the prospect of difficulty is enough to justify the imposition of general rules which are more than likely to work substantial injustice in particular cases.

Recommendation No. 4

We recommend that where expropriated land is subject to a security interest and the outstanding amount secured against the security interest cannot be ascertained,

(a) the compensation payable to the holder of the security interest shall be the fair value of the security interest, and

(b) the compensation payable to the landowner shall be the market value of the land, valued subject to the security interest.

See proposed legislation, s.49(4)

C. Incidental Questions

2.26 Our proposals would change the basis of compensation payable to security holders and landowners. We have considered some questions which arise from the proposed change. While our conclusion in each case is that no further change need be made, we think that we should mention those questions.

(1) Effect of a change in interest rates.

2.27 Under our proposals an expropriator would pay to the holder of a security interest the oustanding amount secured by the security interest so long as that amount is not greater than the market value part of the compensation which would otherwise be payable to the landowner. The expropriator would then pay to the landowner the remainder, if any, of the latter amount.

2.28 The landowner may wish to replace the expropriated land with other land, and he may wish to obtain similar financing. If general interest rates are then higher than when the original security was placed, he will have to pay more for the new financing. Under s.50 of the Expropriation Act, however, a landowner is entitled to claim in respect of disturbance such reasonable costs and expenses as are the natural and reasonable consequences of the expropriation, and we think that this provision is adequate.

2.29 The security holder may wish to reinvest the compensation received upon the expropriation. If general interest rates are then lower than when the original security was placed, he will not be able to find an investment which will give him as great a return. The question then arises: should the security holder be compensated for the loss of the additional return? The answer of the Ontario Law Reform Commission in its Report was yes, and that answer is embodied in s.20(c) of the Ontario Expropriation Act, except that the section limits the security holder's additional compensation to five years' loss.

2.30 We do not think that the Alberta legislation should make a similar provision. The proposition which has been put forward by the Mortgage Loans Association and which we have accepted is that the "outstanding balance" theory provides the closest practicable approximation to fairness. To provide for an additional payment for the loss of an advantageous bargain would give the security holder most of the benefits of the "market value" theory without the burdens necessarily associated with it, and would saddle the expropriator with most of the burdens of the "market value" theory without giving it the associated benefits.

2.31 Section 52(1) of the Expropriation Act gives a security holder a minor benefit, namely, three months' interest

at the rate prescribed by the security document. While we are somewhat doubtful about the principle of the subsection once the "outstanding balance" theory has been adopted, we do not propose that the subsection be changed.

(2) Bonus (discount) and purchase-money mortgages.

2.32 A mortgage loan agreement may provide that the mortgage will secure one amount but that the mortgage lender will advance another and lesser amount. Although it may be characterized as a payment for additional risk, a bonus is paid or a discount allowed to the lender for the use of the money throughout the term of the mortgage loan. The lender is not entitled to be paid the interest which would have accrued under a mortgage after expropriation, and it can be forcefully argued that he should not be entitled to obtain unearned compensation by giving it a different name or form. A majority of our Board has concluded, however, that expropriation law should deal with what the parties actually have at the time of the expropriation, and we accordingly make no recommendation for special treatment of the bonus or discount mortgage. The complexity and artificiality of the assumptions and allocations which such special treatment would require are a further reason for the majority view.

2.33 The Ontario Law Reform Commission recommended in its Report that if the principal and interest outstanding under a bonus mortgage is greater than the market value of the land the mortgagor's liabilty for the deficiency should be reduced by deducting the amount of the bonus from the deficiency. The Commission also recommended that where the principal and interest outstanding under a purchase money mortgage exceeds the market value of the land, the mortgagor should be relieved of any liability on the covenant for the deficiency. Section 17(4) of the Ontario Expropriation Act embodies the Commission's proposals.

2.34 We do not propose that Alberta adopt provisions similar to the Ontario provisions. All landowners are subject to the vagaries of the market, and we do not think that the law should be made complicated in order to single out some of them for special protection against those vagaries.

(3) Participation provisions.

2.35 Some mortgages provide that the landowner will pay to the mortgage lender not only the principal and interest secured by the mortgage but also a share of the profits arising from the business carried on the mortgaged land. If the land is expropriated, should the mortgage lender be compensated for the loss of such a collateral advantage? We think not. Once the "market value" theory is rejected, and the "outstanding balance" theory is accepted, the rationale for attaching to a security interest an additional value because it includes an additional advantage has disappeared.

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CHAIRMAN

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May, 1984

III. List of Recommendations

Recommendation No. 1

We recommend that where expropriated land is subject to a security interest and the outstanding amount secured by the security interest can be ascertained the compensation payable to the security holder:

(a) shall be the outstanding amount secured by the security interest at the effective date of the expropriation,

(b) shall not exceed the market value portion of the compensation payable to the owner of the land,

(c) shall be deducted from the market value portion of the compensation payable to the owner of the land, and

(d) shall be applied against the amount secured by the security interest.

Source: Report, p. 17
Proposed legislation, s.49(2)

Recommendation No. 2

We recommend that where the expropriated land is subject to more than one security interest:

(a) the aggregate compensation payable to all the security holders shall not exceed the market value of the land, and

(b) compensation shall be paid to the security holders in the order of the priority of their respective security interests.

Source: Report, p. 17
Proposed legislation, s.49(3)

Recommendation No. 3

We recommend that where the expropriated land is not all the land subject to the security interest the security holder shall be entitled to be paid out of the compensation for the land expropriated and the damages for injurious affection to the land which is not expropriated the amount that will preserve the pre-existing ratio between the amount secured and the value of the security.

Source: Report, p. 17
Proposed legislation, s.49(5)

Recommendation No. 4

We recommend that where expropriated land is subject to a security interest and the outstanding amount secured against the security interest cannot be ascertained,

(a) the compensation payable to the holder of the security interest shall be the fair value of the security interest, and

(b) the compensation payable to the landowner shall be the market value of the land, valued subject to the security interest.

Source: Report, p. 20
Proposed legislation, s.49(4)

IV. Proposed Legislation

1. The Expropriation Act is amended by this Act.

2. Section 49 is repealed and the following is substituted:

49(1) Notwithstanding Section 48, this section applies if expropriated land is subject to a security interest.

(2) The compensation payable to the security holder

(a) subject to clause (b), shall be the outstanding amount secured by the security interest at the effective date of the expropriation,

(b) shall not exceed the market value portion of the compensation for the expropriated land as determined under section 41,

(c) shall be deducted from the compensation payable to the owner of the land, and

(d) shall be applied against the amount outstanding against the security interest.

Source: Recommendation No. 1, p. 17

(3) Where the expropriated land is subject to more than one security interest subsection (2) applies, but

(a) the aggregate compensation payable to all the security holders shall not exceed the market value portion of the compensation for the expropriated land as determined under section 41, and

(b) compensation shall be paid to the security holders in the order of the priority of their respective security interests.

Source: Recommendation No. 2, p. 17

(4) If the outstanding amount secured by the security interest cannot be determined,

(a) the compensation payable to the security holder shall be the fair value of the security interest, and

(b) the market value portion of the compensation payable to the owner of the land is the amount the land might realize if sold in the open market by a willing seller to a willing buyer subject to the security interest.

Source: Recommendation No. 4, p. 20

(5) If the expropriated land is not all the land subject to the security interest, this section applies but the compensation payable to the security holder is the amount which bears the same ratio to the total of

(a) the market value portion of the compensation determined as set forth in section 41, and

(b) the injurious affection portion of the compensation as determined under section 56,

as the market value of the expropriated portion of the land bears to the market value of all the land subject to the security interest.

Source: Recommendation No. 3, p. 17

V. Appendices

A. Expropriation Act, RSA 1980, c.E-16

41 The market value of land expropriated is the amount the land might be expected to realize if sold in the open market by a willing seller to a willing buyer.

48 When there is more than one separate interest in land, the market value of each separate interest shall, where practical, be established separately.

49(1) When the expropriated land is subject to a security interest, the market value of each person having an interest in the land shall be established.

(2) When the amount owing to the security holder is greater than the market value of his interest and there is no collateral security other than the covenant of the purchaser or borrower to pay the amount of the debt, the security interest shall be deemed to be fully paid, discharged and satisfied on payment to the security holder of the market value of the security.

(3) When the amount owing to the security holder is greater than the market value of his interest and there is collateral security other than the covenant of the purchaser or borrower to pay the amount of the debt, and whether that collateral is by way of security on other property or a guarantee of a third party or otherwise, the compensation shall not fully discharge the debt and the Board shall determine the balance remaining and the manner in which it is to be repaid.

(4) When the expropriation is of a part of land that is subject to a security interest, the Board shall determine the market value of the expropriated part and shall distribute the compensation between the parties as it considers just in the circumstances.

52(1) When the expropriated land is subject to a security interest, the expropriating authority shall pay to the security holder 3 months interest at the rate prescribed in the security document or, if no rate is prescribed, at the rate that would normally be payable in respect of the security, on the amount of the outstanding principal.

(2) When the Board makes a determination under section 48, the amount payable in respect of interest under this section to the security holder shall be in the same proportion in relation to the total payment made on account of interest that the land being expropriated and subject to the security interest bears to the entire amount of land subject to the security interest.

56 When part only of an owner's land is taken, compensation shall be given for

(a) injurious affection, including

(i) severance damage, and

(ii) any reduction in market value to the remaining land, and

(b) incidental damages,

if the injurious affection and incidental damages result from or are likely to result from the taking or from the construction or use of the works for which the land is acquired.

B. List of Those Who Replied to the Discussion Paper

1. City of Edmonton
2. The Mortgage Loans Association of Alberta
3. Montrose Mortgage Corporation
4. Alberta Housing and Public Works
5. The Society of Real Estate Appraisers
6. Canada Life Assurance Company
7. Credit Foncier Franco-Canadien Ltd.
8. Harris G. Field, Q.C., Barrister and Solicitor
9. Canadian Utilities Limited
10. The Canadian Bankers Association
11. Real Estate Division, South Alberta Section, The Canadian Bar Association
12. John D. Rooke, Barrister and Solicitor
13. The Land Compensation Board
14. R.W. Thompson, Barrister and Solictor
15. Gordon S.D. Wright, Barrister and Solicitor